

LITIGATION

In addition to litigation discussed in Note 19 to the Audited Financial Statements (see Exhibit 1 to this Appendix A at Page 50), the following information is provided concerning those matters and other matters which either have arisen since the date of the Audited Financial Statements or are not discussed in Note 19.

In *Parr v. State of California*, described in Note 19 of Exhibit 1, the parties entered into a Settlement Agreement, which has been approved by the Court, and is reflected in a Judgment entered by the Court. Under the terms of the Judgment, a maximum of \$1.3 million will be paid to eligible separated State employees and approximately \$1 million will be paid in statutory attorney's fees and costs. In addition, eligible current State employees will receive employee leave, in an amount presently not quantified.

The appellate court in February 1996 affirmed the trial court finding of State liability in *Akins v. State of California*, litigation involving the results of 1986 flooding in Sacramento and Sutter Counties. In April 1996 the California Supreme Court granted the State's petition for review; briefing is in progress. *Paterno et al. v. State of California*, the 1986 Yuba River flood cases (see Note 19 of Exhibit 1), are currently before the appellate court on liability issues only. Briefing is not expected to be completed until early 1997. A portion of the damages litigation is set for trial in October 1996.

A federal Court of Appeals in the case of *Deanna Beno, et al. v. Donna Shalala, et al.*, reversing a trial court ruling in favor of the State, determined in July, 1994 that the Secretary of the United States Department of Health and Human Services violated the federal Administrative Procedure Act when she approved California's Assistance Payment Demonstration Project, which, in part, granted California a waiver from complying with requirements for state participation in the federal program for medical assistance (Medicaid). The waiver had allowed California to reduce payments under the Aid to Families with Dependent Children program (AFDC) below 1988 payment levels without violating Medicaid requirements relating to maintenance of AFDC payment levels. The Court of Appeals remanded the case to the trial court with instructions to remand the demonstration project to the Secretary for additional consideration of objections raised by the plaintiffs. The State submitted a renewed waiver request to the Secretary, which was granted in early 1996.

One of the features of the 1994-95 Budget Act was a 2.3 percent reduction in AFDC payments. In *Welch v. Anderson*, on August 19, 1994, the San Francisco Superior Court issued a preliminary injunction against the California Director of Social Services to prevent the 2.3 percent AFDC cuts from becoming effective September 1, 1994. The case has been appealed, and on August 16, 1995, the appellate court upheld the issuance of the preliminary injunction. The case on the merits remains pending. Due to the approved federal waiver noted in the previous paragraph, the preliminary injunction has been lifted and the grant reduction has been implemented.

The State is also a respondent/defendant in two additional cases filed by American

Lung Association and Americans for Nonsmokers' Rights (*American Lung Association v. Wilson*; *Americans for Nonsmokers' Rights v. State of California*). These cases challenge the amendment of statutes prescribing specific percentages of tobacco tax revenues to be placed in accounts to be used for health education and research programs, as well as the appropriation of approximately \$63 million in tobacco tax funds for medical treatment programs, pursuant to legislation enacted in July 1995. In September 1995, the Sacramento County Superior Court issued preliminary injunctions, confirming an earlier temporary restraining order, prohibiting the State from issuing, negotiating or processing warrants from the challenged appropriations. The State has appealed the Court's rulings. A hearing on the appeal is anticipated to be scheduled, which the State will contest.

In the case of *Board of Administration, California Public Employees' Retirement System, et al. v. Pete Wilson, Governor, et al.*, plaintiffs challenged the constitutionality of legislation which deferred payment of the State's employer contribution to the Public Employees' Retirement System beginning in Fiscal Year 1992-93. On January 11, 1995, the Sacramento County Superior Court entered a judgment finding that the legislation unconstitutionally impaired the vested contract rights of PERS members. The judgment provides for issuance of a writ of mandate directing State defendants to disregard the provisions of the legislation, to implement the statute governing employer contributions that existed before the changes in the legislation found to be unconstitutional, and to transfer to PERS the 1993-94 and 1994-95 contributions that are unpaid to date. The State defendants have appealed.

In *Jernigan & Burleson v. State*, filed in federal district court, the prison inmate plaintiffs claim they are entitled to minimum wages while working for the Prison Industry Authority. The inmates claim the State has violated the Fair Labor Standards Act (the "FLSA"). Plaintiffs are seeking back pay for the period from August 1990 onward, and liquidated damages, for a total of approximately \$350 million. In June 1995, the district court ruled that the inmates are not employees under the FLSA. The inmates appealed to the Ninth Circuit Court of Appeals, which affirmed the District Court decision holding that the inmates are not employees under the FLSA. The inmates have filed a Petition for Rehearing and a Petition for Hearing En Banc with the Ninth Circuit.

In the consolidated state case of *Malibu Video Systems, et al. v. Kathleen Brown and Abramovitz, et al. v. Wilson, et al.*, a stipulated judgment has been entered requiring return of \$119 million plus interest to specified special funds over a period of up to five years beginning in fiscal year 1996-97. (See Note 19 of Exhibit 1.) The federal cases will be dismissed.

The State has settled *Pearce Investments, Ltd. et al. v. Franchise Tax Board* and related cases (see Note 19 of Exhibit 1) for \$20 million, and the litigation has been dismissed.

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